

Report on Audit of the E-rate Program at St. Augustine School

Table of Contents

	<u>Page</u>
EXECUTIVE SUMMARY	1
BACKGROUND INFORMATION	2
AUDIT OBJECTIVES AND SCOPE	2
AUDIT FINDINGS AND RECOMMENDATIONS	4
OTHER MATTER	8
APPENDIX – Management Response	

EXECUTIVE SUMMARY

On May 7, 1997, the FCC adopted a Universal Service Order implementing the Telecommunications Act of 1996. Included in this Order was the Schools and Libraries Support Mechanism of the USF (hereinafter known as the E-rate program) in which all eligible schools and libraries can receive discounts from the USF on eligible communication services ranging from 20 to 90 percent, depending on economic need and location. The OIG has designed a program of audit oversight to provide FCC management with a reasonable level of assurance that beneficiaries are complying with program rules and that program controls are adequate to prevent fraud, waste and abuse.

The OIG has completed an audit of St. Augustine School (St. Augustine). The objective of this audit was to assess the beneficiary's compliance with the rules and regulations of the USF program and to identify areas in which to improve the program. St. Augustine is a parochial school located in the Bronx borough of New York City. St. Augustine offers classes for pre-kindergarten to 8th grade. Based on its applications filed with the Schools and Libraries Division (SLD) of the Universal Service Administrative Company (USAC), St. Augustine reported that it had 286 students in Funding Years (FY) 1998-2000 and was approved and received funding at an urban discount rate of 90% for those years. The period of our audit was for FYs 1998-2000, covering January 1, 1998 to June 30, 2001.

For the period under audit, St. Augustine had an approved commitment of \$252,157 of which \$179,766 (representing 71% of the approved funding commitment) was approved for installation and maintenance of internal connections. For the period under audit, SLD disbursed \$147,651 of which \$114,705 (representing 78% of the disbursements) was for internal connections.

The audit resulted in four (4) specific findings and \$21,600 identified as potential fund recoveries. We recommend that the Wireline Competition Bureau direct the Universal Service Administrative Company (USAC) to recover \$21,600 disbursed on behalf of St. Augustine in FYs 1998 and 1999 (no recoveries relate to funds disbursed for FY 2000). In addition, we recommend that the Wireline Competition Bureau take steps to ensure that funding requests are adequately reviewed in accordance with existing program rules and implementing procedures to ensure that funding requests associated with these areas of noncompliance with program rules and regulations are not approved. Further, we recommend that the Wireline Competition Bureau review those program rules and implementing procedures governing the areas of noncompliance cited in this report to ensure that those program rules and implementing procedures are adequate to protect the interests of the fund.

We held an exit conference on March 30, 2004 with the beneficiary's representatives, and requested their comments on the results of the audit. They verbally concurred with the results of the audit, but did not provide a written response.

Report on Audit of the E-rate Program at St. Augustine School

We provided management with a copy of our draft report on April 29, 2004 and requested they provide comments on their concurrence with the findings of the audit. In a response dated May 11, 2004, the Wireline Competition Bureau (WCB) indicated that they concurred with our three audit recommendations. WCB's response is included in its entirety in the Appendix to this report.

BACKGROUND INFORMATION

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General (OIG) at the Federal Communications Commission (FCC) has oversight responsibilities for the Universal Service Fund (USF) as a federal program of the FCC. The USF provides affordable access to specified communications services for schools, libraries, rural health care providers, low-income consumers and companies serving high-cost areas. On May 7, 1997, the FCC adopted a Universal Service Order implementing the Telecommunications Act of 1996. Included in this Order was the Schools and Libraries Funding Mechanism of the USF (hereinafter known as the E-rate program) in which all eligible schools and libraries can receive discounts from the USF on eligible communication services ranging from 20 to 90 percent, depending on economic need and location. The Universal Service Administrative Company (USAC) is responsible for administering the Fund under the direction of the FCC's Wireline Competition Bureau (WCB). The Schools and Libraries Division (SLD) of USAC administers the E-rate program.

USF discounts can be applied to three kinds of services and products:

- Telecommunication services, including basic phone service.
- Internet access.
- Internal connections, including wiring and network equipment needed to bring information directly to classrooms or library patrons.

St. Augustine is a parochial school located in the Bronx borough of New York City. St. Augustine offers classes for pre-kindergarten to 8th grade. Based on its applications filed with the Schools and Libraries Division (SLD) of the Universal Service Administrative Company (USAC), St. Augustine reported that it had 286 students in Funding Years (FY) 1998-2000 and was approved and received funding at an urban discount rate of 90% for those years.

The following table summarizes the funding commitments and disbursements for the period of our audit.

Report on Audit of the E-rate Program at St. Augustine School

<u>Funding Years and Services</u>	<u>Funds</u>		<u>Funds</u>	
	<u>Committed</u>	<u>Percent</u>	<u>Disbursed</u>	<u>Percent</u>
FY 1998:				
Internal Connections	\$ 49,484	68%	\$48,250	89%
Internet Access	17,082	23%	5,694	11%
Telecommunications	<u>6,514</u>	<u>9%</u>	<u>0</u>	<u>0%</u>
Subtotal	\$ 73,080	100%	\$53,944	100%
FY 1999:				
Internal Connections	\$ 63,827	73%	\$ 0	0%
Internet Access	16,632	19%	16,632	100%
Telecommunications	<u>7,333</u>	<u>8%</u>	<u>0</u>	<u>0%</u>
Subtotal	\$ 87,792	100%	\$ 16,632	100%
FY 2000:				
Internal Connections	\$ 66,455	73%	\$ 66,455	86%
Internet Access	10,620	11%	10,620	14%
Telecommunications	<u>14,220</u>	<u>16%</u>	<u>0</u>	<u>0%</u>
Subtotal	\$ 91,295	100%	\$ 77,075	100%
Totals	<u>\$252,167</u>		<u>\$147,651</u>	

AUDIT OBJECTIVES AND SCOPE

The OIG has designed a program of audit oversight to provide FCC management with a reasonable level of assurance that beneficiaries are complying with program rules and that program controls are adequate to prevent fraud, waste and abuse. The objective of this audit was to assess the beneficiary's compliance with the rules and regulations of the USF program and to identify areas in which to improve the program.

The scope of this audit was designed to test beneficiary compliance with program requirements contained in Title 47, Part 54 of the Code of Federal Regulations (47 CFR 54.500 through 47 CFR 54.520) which provide that:

- The beneficiary determines its discount percentage by the percentage of their student enrollment that is eligible for a free or reduced price lunch under the national school lunch program or a federally-approved alternative mechanism.
- A process has been established to select the most cost effective service provider.
- Equipment and services are purchased in accordance with applicable procurement rules and regulations, and the applicant has paid its portion of the pre-discounted costs.

Report on Audit of the E-rate Program at St. Augustine School

- Services rendered are consistent with what the beneficiary presented on its application for E-rate funds and were installed or provided before the installation deadline.
- The beneficiary has adequate resources, as certified, to use the discounted service for which funding has been provided.
- The beneficiary has an approved technology plan, as certified.

The period of our audit was for FYs 1998-2000, covering January 1, 1998 to June 30, 2001.

This audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States. As part of the scope of our audit, we obtained an understanding of the specific management controls relevant to the E-rate program. Because of inherent limitations, a study and evaluation made for the limited purposes of our audit would not necessarily disclose all material weaknesses in the control structure. However, we identified significant management weaknesses as discussed in the Audit Results section of this report and in Finding Numbers 1 and 4.

AUDIT FINDINGS AND RECOMMENDATIONS

Our audit of the use of E-rate funds at St. Augustine disclosed that the beneficiary was not compliant with the requirements of the program for funding years 1998 - 2000. The following findings resulted in noncompliant and/or inappropriate funding disbursements:

1. The beneficiary did not pay the entire non-discounted portion of the costs for internal connections and internet access.
2. Internal connections equipment purchased with E-rate funds was missing and unauthorized substitutions of equipment were made, resulting in overpayments of \$4,314.
3. The service provider billed for T-1 internet access but provided less functional integrated services digital network (ISDN) service, resulting in overpayments of \$17,286.
4. There was no documentation to support a competitive bidding process.

Additionally, we have reported as an Other Matter that the supporting documentation for the implementation of and compliance with the E-rate program at St. Augustine was generally very poor.

AUDIT FINDINGS

Finding 1 of 4 - St. Augustine Failed to Pay the Entire Non-discounted Portion of E-rate Costs for Internal Connections and Internet Access.

Report on Audit of the E-rate Program at St. Augustine School

St. Augustine paid only \$14,564 of the \$16,406 non-discounted portion for goods and services received in FYs 1998 - 2000, broken down as follows:

<u>Funding Year</u>	<u>Non-discounted portion</u>	<u>Amount Pd. by St. Augustine</u>	<u>Difference</u>
FY 1998	\$ 5,994	\$ 6,000	\$ (6)
FY 1999	1,848	0	1,848
FY 2000	8,564	8,564	0
Total	<u>\$16,406</u>	<u>\$14,564</u>	<u>\$1,842</u>

The principal of the school during the period under audit stated that, during a review of their technology layout performed by the Archdiocese, St. Augustine found out they had not received all of the equipment and services they had paid for from their service provider, Connect 2, in FY 1998 and therefore refused to pay their non-discounted portion for FY 1999. They stated that they informed both SLD and Connect 2 of their position on this matter.

The FCC, in Universal Service Order CC Docket 96-45 (FCC97-157,) stated that requiring applicants to pay their share would ensure efficiency and accountability in the program. Paragraph 493 of the Order states:

Requiring schools and libraries to pay a share of the cost should encourage them to avoid unnecessary and wasteful expenditures because they will be unlikely to commit their own funds for purchases they cannot use effectively. A percentage discount also encourages schools and libraries to seek the best pre-discount price and to make informed, knowledgeable choices among their options, thereby building in effective fiscal constraints on the account fund.

St. Augustine's failure to account and pay for its share of the non-discounted portion of E-rate services as certified on Form 471 Service Ordered and Certification Form, Block 6, Item 22, is not in compliance with program rules and requirements and would normally lead to a full recovery of funds disbursed. However, our discussions with WCB have indicated that factors such as those present at St. Augustine can mitigate this result. St. Augustine realized that Connect2 was billing the school and USAC for goods and services not being provided and advised USAC of the situation. In our opinion, St. Augustine's actions present mitigating factors that would preclude a recommendation for full recovery of funding based on this finding.

Finding 2 of 4 - Internal Connections Equipment Purchased with E-Rate Funds was Missing and Unauthorized Substitutions Of Equipment were Made, Resulting in Overpayments Of \$4,314.

For FY 1998, our on-site inspection of the internal connections equipment and audit of supporting documentation revealed that some E-rate equipment could not be found and some of the equipment installed was significantly different from the equipment listed

Report on Audit of the E-rate Program at St. Augustine School

on the approved Form 471 (Services Ordered and Certification Form), Item 17 attachment quote/contract. SLD approved, committed and disbursed funds to Connect 2 based on the approved Form 471 funding request numbers. The physical inventory at St. Augustine revealed that thirteen (13) equipment units, for which SLD disbursed \$4,314 of funding (the pre-discount price of this equipment was \$4,793), were missing. The following table shows the equipment items not found and the associated pre-discount charge.

Equipment	Units	Pre-Discount Price
Bay Networks Hub, 12 Port	14	\$7,266
Bay Networks Smart Hub, 24 Port	(1)	(999)
Bay Networks Smart Hub, 12 Port 10/100	2	2,072
Bay Networks Smart Switch, 24 Port FX option	(1)	(3,996)
Equipment Cabinet/Shelving	(1)	(1,050)
Bay Networks Internet Box w/T-1 (model CQ1001078)	1	3,995
Bay Networks Internet Box w/ISDN (model CQ1001090)	(1)	(2,495)
Total	13	\$4,793

Note that this table includes units that were installed by Connect 2, but were not on the original inventory listing. We were able to ascertain the value of these hubs and reduced the cost of the missing equipment because it is possible these hubs were installed in lieu of other equipment.

On the FCC Form 473 (Service Provider Certification Form), the service provider certifies that charges reflected on the FCC Form 474 (Service Provider Invoice Form) will be based on bills or invoices billed to the beneficiary. Moreover, instructions to Form 474 require that the service provider has to provide the products and services and to bill the school or library for the non-discounted portion prior to submitting a FCC Form 474 to USAC/SLD. Because the amounts invoiced by Connect 2 on the FCC Form 474 (Service Provider Invoice Form) were submitted as line items in the aggregate by funding request numbers (FRNs) without any breakdowns by unit/price, SLD had no knowledge of any product substitutions and relied on the original service/equipment list attached to Item 17 of the FCC Form 471 (Services Ordered and Certification Form). Consequently, SLD approved the disbursement to the extent the E-rate funds requested did not exceed the approved committed FRN amounts. SLD has no record of these substitutions, and therefore, issued no letters authorizing these substitutions. However, we were unable to determine if the substituted equipment resulted in a less functional system with the exception of the level of internet service. This issue is discussed in finding 3 of 4.

Finding 3 of 4 - The service provider billed for T-1 internet access but provided less functional integrated services digital network (ISDN) service, resulting in overpayments of \$17,286.

Report on Audit of the E-rate Program at St. Augustine School

Using Verizon Communications Inc.'s (Verizon d/b/a Bell Atlantic) customer billing records, it was determined that St. Augustine had ISDN service only from April 1999 to October 2000. Furthermore, we determined that the equipment provided was not able to support T-1 service. SLD paid Connect 2 a total of \$22,326 for internet access at St. Augustine for FYs 1998 and 1999.

We have determined that the service provider, Connect 2, was over paid \$17,286 for monthly recurring charges for ISDN service for Internet access billed at rates for a full T-1 service during FY 1998 and FY 1999. The calculation of this amount is too voluminous for inclusion in this report, but can be made available upon request.

Included in the approved and funded internal connections for St. Augustine was a Bay Networks Instant Internet Box, model no. CQ1001078 manufactured by Nortel Networks. This unit supports full T-1 internet service. However, the internet box that was installed at St. Augustine was a Nortel Networks Bay Networks Instant Internet Box, model no. CQ1001090. With the assistance of the manufacturer and the Office of Engineering and Technology (OET) we determined that the capabilities of this unit were limited to ISDN internet service. This unauthorized service substitution represents a clear degradation of system functionality, see finding 2 of 4 for more details on the impact of this issue.

On the FCC Form 473 (Service Provider Certification Form), the service provider certifies that charges reflected on the FCC Form 474 (Service Provider Invoice Form) will be based on bills or invoices billed to the beneficiary. Moreover, instructions to Form 474 require that the service provider has to provide the products and services and to bill the school or library for the non-discounted portion prior to submitting a FCC Form 474 to USAC/SLD. In addition, the FCC Rules in Sec. 54.507 (b) states that a funding year for purposes of the schools and libraries cap shall be the period July 1 through June 30; and Section 54.507(e) states that if schools and libraries enter into long term contracts for eligible services, the Administrator (USAC/SLD) shall only commit funds to cover the pro-rated portion of such a long term contract scheduled to be delivered during the funding year for which universal service support is sought. Connect 2 over-billed SLD for the ISDN services based on rates for T-1 services for Internet access for FY 1998 and FY 1999 and was not in compliance with program rules and regulations.

Finding 4 of 4 – No Documentation to Support a Competitive Bidding Process.

St. Augustine was not able to provide any evidence of a competitive bidding process. The school representatives informed us that, during FYs 1998 and 1999, their E-rate consultant controlled their entire application process and directed their work to Connect 2. They also stated that, to the best of their knowledge, there were no other quotes obtained and reviewed other than the Connect 2 bid. They changed service providers in FY 2000 to Elite Systems at the recommendation of a consultant that worked for the Archdiocese Patrons Program. It was later disclosed that the Archdiocese consultant was also connected to Elite Systems, by either family or ownership, while working for

Report on Audit of the E-rate Program at St. Augustine School

the Archdiocese. We were not able to determine if this connection resulted in unfair or unethical practices on the part of Elite Systems, but the apparent conflict of interest leads us to the conclusion that there was no competitive process followed in awarding the FY 2000 contract to Elite Systems.

Title 47 CFR 54.504, Requests for Service (a) competitive bidding requirement, provides that all eligible schools, libraries and consortia including those entities shall participate in a competitive bidding process, pursuant to the requirement established in this subpart, but this requirement will not preempt state or local competitive bidding requirements. Section 54.511, Ordering Service, (a) Selecting a provider of eligible services, provides that in selecting a provider of eligible services, schools, libraries and consortia including any of those entities shall carefully consider all bids submitted and may consider relevant factors other than the pre-discounted prices submitted by providers. St. Augustine was not able to provide documents that would support the soundness of their management of the E-rate funding or compliance with Title 47 CFR 54.504 and 511.

RECOMMENDATIONS

Recommendation 1 of 3 – We recommend that the Wireline Competition Bureau direct the Universal Service Administrative Company to recover the amount of \$21,600 disbursed for internal connections and internet access on behalf of St. Augustine in funding years 1998-1999.

Recommendation 2 of 3 - We recommend that the Wireline Competition Bureau take steps to ensure that funding requests are adequately reviewed in accordance with existing program rules and implementing procedures to ensure that funding requests associated with these areas of noncompliance with program rules and regulations are not approved.

Recommendation 3 of 3 - We recommend that the Wireline Competition Bureau review those program rules and implementing procedures governing the areas of noncompliance cited in this report to ensure that those program rules and implementing procedures are adequate to protect the interests of the fund.

OTHER MATTER

In general, the supporting documentation for all aspects of St. Augustine's E-rate participation was weak. School representatives informed us that this was due to their E-rate consultant controlling the process. They were not given copies of most of the paperwork associated with their applications and had little knowledge of what was going on throughout the process. We were able to perform our audit by using other sources of information, but the general lack of documentation at St. Augustine had a negative impact on our ability to conduct this audit efficiently.

Report on Audit of the E-rate Program at St. Augustine School

Since this is not a rule violation we have not cited this as an audit finding. However, we do consider it to be a matter of interest and suggest that the WCB consider ways to ensure that E-rate applicants are required to maintain documentation that supports their E-rate participation, to include support for the discount calculation, the competitive process, inventory, and payment for goods and services rendered.

FEDERAL COMMUNICATIONS COMMISSION

OFFICE OF INSPECTOR GENERAL



Report on Audit of the E-Rate Program at St. Augustine School

Report No. 02-AUD-02-04-017

APPENDIX – Management Response

Memorandum

DATE: May 12, 2004

TO: Inspector General

FROM: Managing Director

SUBJECT: Draft Reports on Audits of E-Rate Programs at St. Augustine School and United Talmudical Academy

Attached are the Wireline Competition Bureau's responses to the draft reports on the audits of the e-rate programs at St. Augustine School and United Talmudical Academy. We had asked the Bureau to submit its responses to you through the Office of Managing Director. If you have any questions or concerns please contact Jerry Cowden. Thank you.



Andy Fishel

Attachments:

1. Response to Draft Report on Audit of the E-rate Program at St. Augustine School
2. Response to Draft Report on Audit of the E-rate Program at United Talmudical Academy



Wireline Competition Bureau

MEMORANDUM

DATE: May 11, 2004

TO: Inspector General

FROM: William F. Maher, Jr. *WFM*
Chief, Wireline Competition Bureau

SUBJECT: Report on Audit of the E-rate Program at St. Augustine School.

Attached please find WCB's response to the OIG's audit report on St. Augustine School.

St. Augustine School

Recommendation 1 of 3: recover the amount of \$21,600 disbursed in funding years 1998 and 1999.

Wireline Competition Bureau Response: Concur

Explanation: The OIG concludes in finding #1 that St. Augustine's did not pay its full nondiscounted share in funding year 1999, but states that St. Augustine's actions -- specifically, the fact that it declined to pay for items not provided to it and advised USAC of this situation -- present mitigating factors that preclude a recommendation for full recovery of funding based on this finding. The Commission has never addressed whether waiver of the requirement that a beneficiary pay its full nondiscounted share is appropriate in specific circumstances. Because this is a new and novel issue, WCB plans to recommend to the Commission that it endorse an approach in which mitigating factors justify waiving this rule, and therefore provide a basis for not recovering funds.

The OIG concludes in finding #2 that internal connections equipment purchased with E-rate funds was missing and unauthorized substitutions of equipment were made. We concur that the information summarized in the audit report supports recovery for unauthorized substitutions.

The OIG concludes in finding #3 that the service provider billed for T-1 internet access but provided a less functional integrated services digital network (ISDN) service. We concur that the information summarized in the audit report supports a conclusion that the service provider billed for T-1 internet access but provided a less functional ISDN service. The OIG concludes in finding #4 that there was no documented competitive bidding process. Because no recovery is recommended by OIG we do not address recovery for this finding.

Recommendation 2 of 3: WCB should take steps to ensure that funding requests are adequately reviewed in accordance with existing program rules and implementing procedures to ensure that funding requests associated with this area of noncompliance with program rules are not approved.

Wireline Competition Bureau Response: Concur

Explanation: We agree with the OIG that we should take steps to ensure that funding requests are adequately reviewed in accordance with Commission rules and USAC procedures. WCB will work with USAC to determine whether additional procedures are warranted to address the issues identified in the report.

Recommendation 3 of 3: WCB should review those program rules and implementing procedures governing the area of noncompliance cited to in this report to ensure that those program rules and implementing procedures are adequate to protect the interests of the fund.

Wireline Competition Bureau Response: Concur

Explanation: We agree with the OIG that we should review the existing program rules and implementing procedures governing the areas of noncompliance to ensure that program rules and implementing procedures are adequate to protect the interests of the fund. We are already taking action in this regard as discussed below.

In January 2002, based on WCB's recommendation, the Commission initiated a rulemaking to consider, among other things, measures to limit fraud, waste and abuse in the e-rate program. In April 2003, the Commission sought further comment on additional issues relating to E-rate. In December 2003, the Commission adopted an Order that adopted additional measures to limit fraud, waste and abuse and sought comment on other issues relating to E-rate.

With regard to finding #2, in, December 2003 the Commission adopted rules prohibiting the transfer of equipment purchased as part of internal connections for a period of three years after purchase, except due to temporary or permanent closing of a school or library branch. The Commission's December 2003 Order also requires beneficiaries to make reasonable use of certifications in which they promise to use the equipment purchased with USF discounts at the location and for the purpose requested. To verify compliance with these requirements, the Order also requires beneficiaries to keep an asset inventory for a period of five years. These changes become effective in funding year 2005

With regard to finding #4 and funding provided to Elite Systems in FY 2000, WCB will direct USAC to perform additional audit procedures to determine compliance with the Commission's competitive bidding rules in FY 2000 and subsequent years. Also, with regard to finding #4, the Commission has sought comment on whether program participants should be required to retain records for a period of five years.

WCB is considering the other findings as part of our ongoing efforts to improve the Commission's oversight over the E-rate program and reduce occurrences of waste, fraud and abuse.

The Commission has debarred 2 principals involved in the day to day operation of Connect 2 due to e-rate rule violations. WCB will direct USAC to review applications that selected Connect 2 as a service provider to ascertain whether similar irregularities have occurred and to refer such instances to appropriate law enforcement agencies for further investigation if appropriate.